



2001 M Street, N.W.
Washington, D.C. 20036

March 31, 2001

To the Mayor and Council of the Government of the District of Columbia

Inspector General of the Government of the District of Columbia

District of Columbia Financial Responsibility
and Management Assistance Authority

We have audited the general purpose financial statements of the Government of the District of Columbia (the District), as of and for the year ended September 30, 2000, and have issued our report thereon dated January 26, 2001. In planning and performing our audit of the general purpose financial statements of the District, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration in the Executive Summary and Appendix A to this letter. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies. This letter presents our comments and recommendations related to Central District operations only. Our observations and recommendations related to District agencies for which stand alone audited financial statements have been issued are provided in separate letters.

Our audit procedures are designed primarily to enable us to form an opinion on the general purpose financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the District's organization gained during our work to make comments and suggestions that we hope will be useful to you. We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the Mayor and Council of the District of Columbia, the Inspector General of the District of Columbia, the District of Columbia Financial Responsibility And Management Assistance Authority, and Chief Financial Officer and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP



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EXECUTIVE SUMMARY

With the issuance of the District's fiscal year 2000 Comprehensive Annual Financial Report (CAFR), a significant milestone was achieved. The certification of the fiscal year 2000 audit results by the Financial Responsibility and Management Assistance Authority (Authority), have set events in motion that will result in the suspension of the Authority's activities. This is certainly cause for celebration over how much progress the District has made in improving its financial condition over the last four years; but it is also cause for reflection on what needs to be done to ensure future financial stability. We believe it is critical for the District to sustain the momentum it has generated from its improving financial management infrastructure. Much has been accomplished, but much remains to be done to ensure financial management processes are securely in place to routinely produce timely, relevant information useful to decision makers.

Address Material Weaknesses and Reportable Conditions

Addressing the material weaknesses and reportable conditions that were highlighted in our Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards, should be the first step in continuing to improve the financial management infrastructure. Our findings and recommendations related to material weaknesses and other reportable conditions are identified in that report and are included as Appendix B to this management letter for convenient reference.

Material weaknesses which we believe should be immediately addressed by the Office of the Chief Financial Officer (OCFO) are as follows:

- Reconciliation of bank accounts and cash management
- Accounting for payroll transactions
- Disability compensation claims management
- University of the District of Columbia transaction processing
- Public Benefit Corporation transaction processing

Other reportable conditions related to significant deficiencies in the design or operation of internal controls, that should also be a high priority for OCFO attention, are as follows:

- Lack of timely entry of transactions into SOAR
- Accounting and reporting of intra-District transactions
- Failure to monitor expenditures against open procurements
- Inadequate access controls over District information systems
- Timely reporting of budgetary revisions

Our management letter highlights other observations we made during the conduct of our audit that we *believe should be considered by the District as it continues to improve its financial management infrastructure*. Many of our observations represent “best practices” in internal control and financial management against which we believe the District should be measuring itself. We have also included observations concerning the impact of changes in governmental accounting standards that the District must implement over the next two fiscal years. Our summary of our most significant observations is presented in the following paragraphs. These comments, and other matters we believe should be brought to management’s attention, are presented in detail in Appendix A. The status of prior year material weaknesses are presented in Appendix C. The status of prior year management letter comments are presented in Appendix D.

Internal Control Observations

- The District continues to identify areas of its operations to outsource in order to achieve efficiencies, improved customer service, and cost savings. To the extent the District operations are outsourced to third-party service organizations for transaction processing (e.g., benefit claims, tax returns, investment management, lottery ticket sales, etc.), the service organization’s controls over the processed transactions are integral to the District’s overall internal control structure. In order to assure itself that effective internal controls are in place, we recommend the District require the service organization to provide a SAS 70 report on the design and operation of internal controls related to the processing of the outsourced transactions.
- *The District receives over \$1 billion per year in operating and capital grants from the federal government.* Grant agreements generally require the District to report annually to the federal government, amounts received and expended under the terms of the grants. Additionally, many grants require more frequent reporting, such as monthly or quarterly. We observed that reconciliations of amounts reported to the federal government to the corresponding amounts recorded in the general ledger are infrequently performed at times other than year-end. We recommend that the District reconcile its grant reports to the general ledger for each report submitted to the federal government to ensure that it is capturing and reporting all costs eligible for reimbursement.

Financial Management Observations

- The Office of Finance and Treasury (OFT), and specifically the District Treasurer, is responsible for ensuring cash and investments are effectively and efficiently managed. We observed that the District maintains over 1,500 bank accounts, many of which are under the direct control of agencies rather than the District Treasurer. Because these accounts are not part of the overall cash management process or the deposit collateralization process monitored by the District Treasurer on a District-wide basis. As a result, investment earnings are not maximized and the risk of noncompliance with deposit collateralization requirements is increased. We recommend that the District Treasurer evaluate whether the number of separate bank accounts can be reduced and take appropriate action to ensure that all District bank accounts are effectively monitored for compliance with *District-wide cash management and deposit collateralization policies*.

- The Office of Contracts and Procurement (OCP) coordinates procurement activity for many, but not all, District agencies. Because certain agencies have their own procurement authority and have established their own processes, OCP is unable to monitor effectively District-wide procurement activity such as sole source procurements, emergency procurements, and other performance statistics. We recommend that OCP require those agencies that have been delegated separate procurement authority to submit a summary of their activity to OCP on a monthly basis. This will allow District management to monitor the efficiency and effectiveness of the overall procurement process.
- The District maintains almost \$5.5 million in general fixed assets. While the District maintains detailed records supporting these amounts, there are significant reconciling items between the records maintained at the agency level and those maintained by OCFO. We recommend that the District update its most recent physical inventory of all general fixed assets, last performed in 1997, and post any adjustments arising out of the inventory to the supporting records.

New Accounting Standards

- Governmental Accounting Standard Board (GASB) Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (GASB 33), establishes accounting and financial reporting standards to guide decisions about when to report the results of nonexchange transactions, such as sales and income taxes, property taxes, and federal grants. The District is required to implement the provisions of GASB 33 during fiscal year 2001. This Statement will have a significant impact on the District's accounting and reporting for grants received from the federal government.

Historically, the District has reported revenues from most federal grants only to the extent that it has incurred expenditures under the terms of grant agreements. However, GASB 33 requires that each individual grant be analyzed to determine when the District is eligible to recognize revenue. We believe it is likely that revenue from many of the block grants the District receives, as well as multi-year grants, will need to be accrued under GASB 33 earlier than it has been in the past. We encourage the District to begin analyzing the impact of GASB 33 on its revenue recognition policies and to assess the related impact on its fiscal year 2001 financial statements.

- GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB 34), is perhaps the most far reaching accounting standard ever issued by the GASB. This standard creates two new, government-wide statements that present the net assets and activities of the District on a full accrual basis. These statements supplement the fund financial statements that have historically been presented. Additionally, GASB 34 requires inclusion of management's discussion and analysis (MD&A), a narrative discussion of the financial operations of the District, which is very similar to, but more expansive than, the transmittal letter currently presented in the CAFR.

Because of its complexity, GASB 34 will be extremely difficult to implement. OCFO is in the process of procuring assistance to implement this new standard. Once this procurement is finalized, we encourage the District to establish a "GASB 34 Steering Committee" to monitor the progress towards successful GASB 34 implementation. Integral to this success will be active participation by senior management of the District, and support from the Council. We would be pleased to present an overview of the GASB 34 requirements to Council upon its request.

Process	Financial Management
Title	<i>Obtain SAS 70 Reports for Outsourced Transaction Processing</i>
Observation	The District continues to identify areas of its operations to outsource to private organizations to achieve cost savings. These outsourced operations often include integral elements of the District's internal control structure. For example, the Office of Tax and Revenue has outsourced certain tax return processing and management functions to a third-party. The District must ensure that the financial information provided by the contractor to the District, and therefore used to post to SOAR, may be relied upon.
Recommendation	<p>Statement on Auditing Standards No. 70, <i>Reports on the Processing of Transactions by Service Organizations</i> (SAS 70), provides guidance to auditors on the preparation of reports on their evaluation of the design and operation of key controls in place at a service organization. It is the operation of those key controls that should be of primary interest to District management. The District should require service organizations that provide transaction processing services and produce financial data used for input to the general ledger, to obtain a SAS 70 audit and submit the resultant report to the District so that the OCFO can properly rely on that information. We have identified the following types of service organizations that the District currently uses, from which a SAS 70 report should be obtained:</p> <ul style="list-style-type: none"> • Investment managers and custodians • Bank trust departments that maintain collateral • Department of Employment Services claims management contractors • Department of Housing and Community Development loan servicing contractors • Lottery Technology Enterprises, which runs the on-line gaming system of the DC Lottery <p>We observed that the District does obtain SAS 70 reports for its Medicaid Management Information System and for its BOSS system over the electronic benefits transfer process for TANF and Food Stamps. We recommend that the District continue to obtain these reports annually to monitor internal control at these significant vendors.</p>
Management's Response	<i>The Chief Financial Officer (CFO) concurs with the auditor's transaction processing recommendation regarding the Statement on Auditing Standards No. 70, Reports on the Processing of Transactions by Service Organizations (SAS 70). The CFO will direct the Office of Internal Audit and Internal Security (IAIS) to obtain and review the reports from the service organizations cited by the auditors. In addition, the Office of Internal Audit and Internal Security will work with the District's procurement officials to require service organizations to obtain a SAS 70 audit and submit the resultant report to the District.</i>

Process	Financial Management
Title	<i>Improving the CAFR Closing Process</i>
Observation	<p>The District's charter requires it to present an annual audited financial statement to Congress by February 1 following the end of each fiscal year. The annual process of completing the CAFR by February 1 is extremely labor-intensive. Without extraordinary efforts by individuals within the OCFO, the CAFR would not be able to be completed timely. Additionally, all closing packages, still the primary process for reconciling agency activity to SOAR, may be approved only by a limited number of OFOS employees, which can cause delay in CAFR preparation.</p> <p>Each agency of the District is required to submit a closing package to OFOS that must be reviewed. Based on the September 30, 2000, closing package guidance provided to agencies, there could potentially be over 2,500 closing packages possibly submitted by OFOS. In fact, over 1,500 closing packages were reviewed by OFOS during the fiscal year 2000 audit. We observed that much of the information provided to OFOS in the closing packages is merely data summarized from SOAR, which is already accessible by OFOS. This results in preparation time by the agencies and review time by OFOS which adds little value to the closing process.</p>
Recommendation	<p>We recommend OFOS evaluate the effectiveness of the current closing process, including the utility of the required closing packages. Although SOAR has been in place for two years, the closing process, as it existed pre-SOAR, has not changed. Guidance provided by OFOS to the agencies must be customized to indicate exactly what information must be provided to OFOS to facilitate preparation of specific disclosures in the CAFR. Because SOAR is a distributed accounting system, OFOS should change its role in the closing process to take advantage of the system's capabilities. The institutional knowledge about the closing process that resides in OFOS should be shared with the agencies providing input to the closing process in order for it to function efficiently. OFOS should function in much more of an analytical and oversight capacity. OFOS should also consider redefinition of the roles of OFOS employees to assign oversight responsibilities for specific agencies, rather than over specific processes. These roles could then be aligned with similar oversight roles assigned in the Office of Budget and Planning. This would give the District oversight coverage of both the financial and budgetary reporting processes at the agency level.</p>
Management's Response	<p><i>Concur. OFOS is presently revamping its closing procedures and its role to take advantage of the new capabilities offered by SOAR. The new closing procedures will be released to the agencies on a progressive basis for the interim closings of March 31, 2001 and June 30, 2001. The new procedures will result in the elimination of a significant number of closing packages since OFOS will be utilizing SOAR to confirm the work performed by agencies.</i></p> <p><i>OFOS, as a result of the assistance provided by the OCFO and the SOAR Executive Steering Committee in the creation of the Accounting Systems Manager Program, will be able to assign accountants to specific agencies rather than specific processes.</i></p>

Process	Cash Management
Title	Coordinated Management of Pooled and Agency-Controlled Cash
Observation	<p>As of September 30, 2000, the pooled cash management system of the District consisted of 43 bank accounts. There were also over 1,500 bank accounts under agency control, including over 500 bank accounts at the Public Schools and over 300 at the Department of Housing and Community Development. By maintaining so many bank accounts, the District is also incurring significant time and effort in maintaining and reconciling these accounts.</p> <p>OFT was unaware of the existence of many of the accounts under agency control. Consequently, these accounts were not included in the collateralization process established by OFT to ensure that all public deposits are adequately collateralized in accordance with District laws. We also observed that many agency controlled accounts are not subject to the overnight investment "sweep" process even if there are other District accounts at the same financial institution that are swept daily.</p>
Recommendation	<p>We recommend the District evaluate the utility of all bank accounts that are open. Benchmarks against various state and local governments indicate that the District maintains significantly more bank accounts than its peers. The result of this review will likely be the consolidation of numerous bank accounts and the prompt closing of a significant number of other accounts. We further recommend that OFT establish procedures to ensure that it is notified of any bank accounts that agencies want to open under their control. We believe that the ultimate decision to establish a bank account should reside with the District's Treasurer.</p> <p>Finally, we recommend that, concurrent with the review of the bank accounts outlined above, the District fully integrate agency-controlled bank accounts into the cash management and collateralization processes established by OFT. By bringing the millions of dollars in agency-controlled cash under the District's overnight investment sweep process, interest revenue earned on available cash balances will be maximized. Care must be taken to ensure that interest earned on such balances is recorded and utilized properly, such as reinvested in the applicable grant programs whose balances generated the interest earned, or returned to the federal government, if required. By coordinating both pooled and agency-controlled cash balances, the District can also ensure that the proper amount of collateral on public deposits is maintained by financial institutions as required by law.</p>
Management's Response	<p><i>We agree with the recommendation. OFT will continue its initiative to work with District agencies and financial institutions to identify, close and consolidate un-needed bank accounts. A strategy has been developed and is in progress to work with the agencies (especially DCPS and DHCD) with the largest number of accounts to reduce. In addition, a CFO Order will be issued to all District agencies outlining the procedures to open, maintain and close bank accounts to comply with the requirements of the Financial Institutions Deposit and Investment Amendment Act of 1997.</i></p>

Process	Grants Management
Title	Improve Reconciliation of Grants Activity
Observation	<p>The District receives over \$1 billion per year in operating and capital grants from the federal government. Each grant agreement requires that the District report annually to the federal government amounts received and expended under the grant. Additionally, many grants require more frequent reporting, such as quarterly</p> <p>OFOS and OFT have centralized the receipt of grant proceeds, requiring that agencies report when they have applied for reimbursement or draw down of federal funds, facilitating the timely recordation of those funds. However, we observed that there is no linkage between the reimbursement or draw down of these federal funds and the expenditure of these funds. It is therefore very difficult for the District to monitor its compliance with the Cash Management Improvement Act (CMIA).</p> <p>We further observed that the grant reports submitted by the District are often difficult to reconcile to the general ledger as required by federal regulations. We believe that many agencies use information not contained in SOAR to prepare the federal reports. This subledger information appears to be maintained timely by the agencies; however, it is not reconciled to SOAR timely.</p>
Recommendation	<p>We recommend that OFOS modify its procedures for tracking of federal grant draw down activity to facilitate monitoring of CMIA compliance. OFOS should require that agencies indicate that federal monies have either been (1) received in advance of incurring allowable costs but have been drawn in accordance with CMIA regulations or (2) received as reimbursement for allowable costs already incurred.</p> <p>We further recommend that the District improve its processes for reconciling the submitted federal reports to SOAR. All federal reports, whether submitted quarterly or annually, should be supported by SOAR balances. Prior to approving the submission of the report, management should review the reconciliation to SOAR. This will help ensure that all information used to prepare federal reports is reconciled to SOAR timely. Implementing this key control will also reduce the number of findings reported during the Single Audits of various District grant programs.</p>
Management's Response	<p><i>The Office of Finance and Treasury (OFT) is responsible for the oversight of the Cash Management Improvement Act (CMIA). OFT monitors that cash collections of all agencies that receive federal grants and specifically those that are covered by the Treasury State Agreement (TSA) which for the District are those grants \$3 million and greater.</i></p> <p><i>OFT has created reports in the Executive Information System (EIS) Impromptu that allow for the tracking of federal grant expenditures and the subsequent collections. OFT staff interfaces with agency staff weekly to insure that collections are occurring. The larger agencies typically draw down funds weekly and bi-weekly for cash expenditures. When the funds are received, by electronic transfer, OFT notifies the agency daily and the funds are recorded in the financial system. If funds are received for costs that have incurred (cash expenditures), the agency records the deposit as cash revenue. If the funds are received in advance of expenditures, the agency records the cash as deferred revenue until such time as the deferred revenue is expended, or if warranted returned to the federal government.</i></p>

Process	Procurement
Title	Improve Coordination of Procurement Activities
Observation	<p>The District's procurements each year for goods and services exceeds \$1 billion. The Office of Contracts and Procurement (OCP) is responsible for procuring goods and services for the majority of District agencies. However, many of the major agencies – such as Public Schools and Public Works – have been delegated their own procurement authority by OCP. These agencies have set up procurement infrastructures that mirror those established by OCP.</p> <p>We observed that there are many procurement management statistics that the District is not tracking to evaluate the effectiveness and efficiency of the process. For instance, the District could not provide a listing, on a timely basis, of all sole source or emergency procurements made. Additionally, agencies delegated their own procurement authority could not provide this information to OCP timely. Further, little performance information, such as the time elapsed from the posting of the request for proposal to the contract award date, is available.</p> <p>We further observed that there is no standard system for assigning procurement identification numbers across all District agencies. The ADPICS system in SOAR has functionality to be used as such a system, but to date, the District has not fully implemented the procurement capabilities of ADPICS. ADPICS is currently used as an accounts payable system at the back end of the procurement process, but it is not linked to the front end of the procurement process.</p>
Recommendation	<p>We recommend the District improve its coordination between OCP and the various agencies delegated procurement authority in order to provide senior District management with access to up to date procurement information. This information will assist the District in assuring that service delivery to District residents is optimized and allow District management to assess whether the current decentralized procurement process is working effectively and efficiently. The District must adopt performance measures against which both OCP and agencies are monitored.</p> <p>We further recommend that the District continue in its efforts to implement ADPICS at the front end of the procurement process. Using ADPICS to automate the procurement management process will also provide District management with relevant performance statistics against which to measure OCP and agency performance.</p>
Management's Response	<p><i>The Office of Contracting and Procurement is currently implementing appropriate aspects of ADPICS and looking at effective procurement systems to interface with SOAR. The OCP has taken, or will implement the following actions to coordinate procurement activities and resolve audit finding:</i></p> <ol style="list-style-type: none"> <i>1. Issue an OCP Directive to establish standard contract file documentation and placement requirements for all contract files. [To be issued in next 30 days.]</i> <i>2. Issued (on August 24, 2000) OCP Directive 8001.00, Uniform Procurement Instrument Identification Numbering System, which establishes and implements a uniform procurement identification and numbering system for all solicitations, contracts, purchase orders and related instruments.</i>

Management's Response (continued)	<ol style="list-style-type: none"> 3. <i>Issued (on September 14, 2000) OCP Directive 8003.00, Contractor past Performance Evaluation And Assessment, which establishes and implements a uniform program for the systematic evaluation and assessment of contractor performance, and to monitor the level of compliance with contract requirements by contractors.</i> 4. <i>Issued (on September 21, 2000) OCP Directive 4000.00, Business Clearance Review and Approval Requirements Prior To Entering Into Contract Actions which requires that contracting and business approvals be obtained prior to entering into government contract actions under the authority of the Chief Procurement Officer, outlines the review and approval process, and facilitates the proper, appropriate and complete documentation of the record of contract actions, including requirements for the following supporting documentation: Determination and Findings (D&F documents), technical evaluation panel reports, market surveys, and cost and price analyses.</i> 5. <i>Initiated an intensive Contracting Officer Technical Representative (COTR) training program (four (4) sessions) for program officials and staff, as well as contracting staff. It is the program officials and staff that are primarily responsible for contract monitoring and contractor performance.</i> <p><i>Developed an intensive, diversified and on-going staff training and development program for all OCP Contracting Officers, Contract Specialists, Procurement Specialists, as well as program officials and staff.</i></p>
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